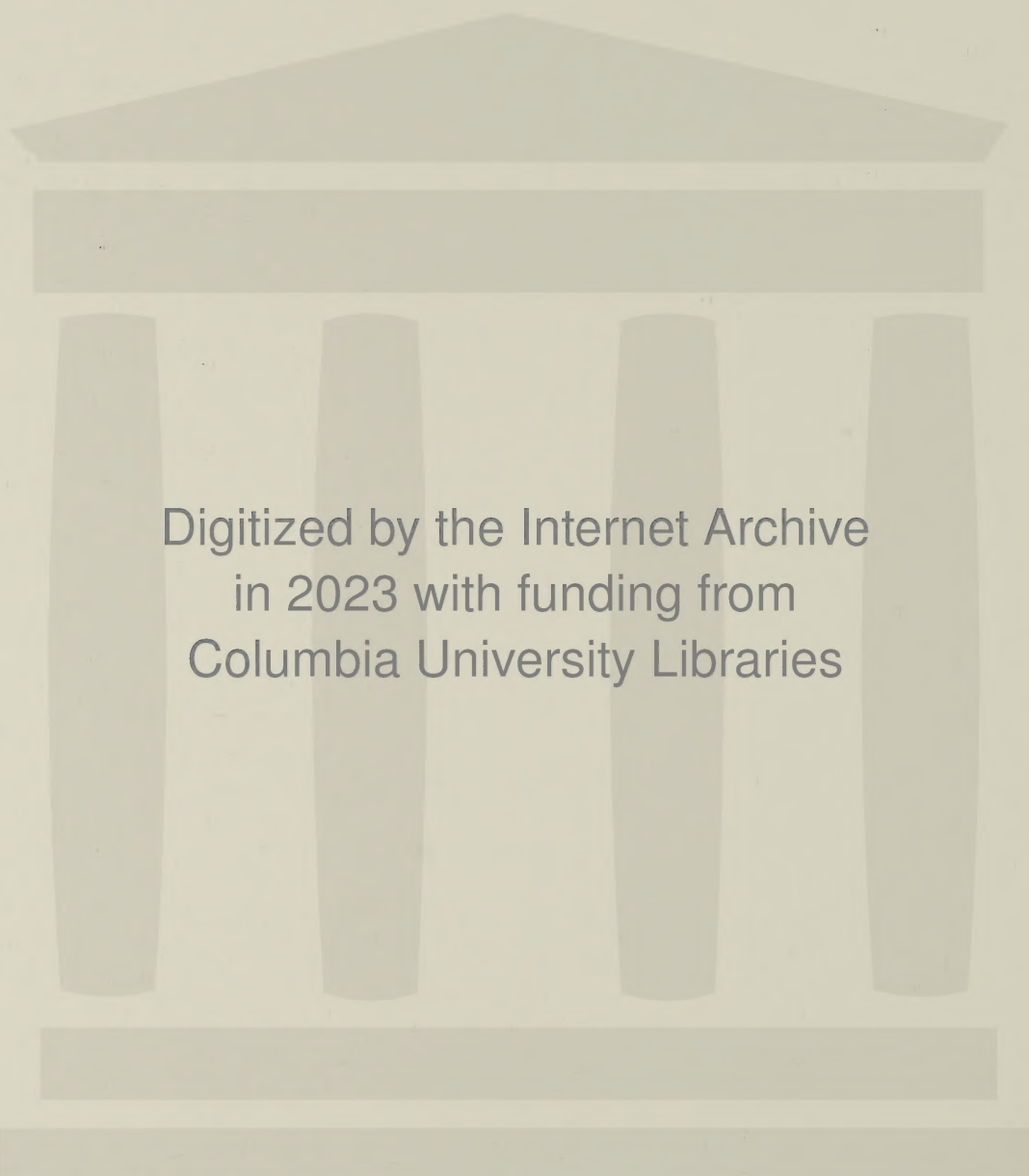


# **The Harriman Institute Forum**

**Padma Desai**

**FROM THE SOVIET UNION  
TO THE COMMONWEALTH OF  
INDEPENDENT STATES:  
THE AID DEBATE**

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## From the Soviet Union to the Commonwealth of Independent States: The Aid Debate

**Padma Desai**

The aid debate was thrown into a flurry of media attention in March 1992, when former President Richard Nixon revived the issue of helping Russia with a dramatic warning: "The hot-button issue in the 1950s was, 'Who lost China?' If Mr. Yeltsin goes down, the question 'Who lost Russia?' will be an infinitely more devastating issue in the 1990s" (*Wall Street Journal*, 11 March 1992).

This pronouncement, coupled with the desire to preempt Governor Clinton's forthcoming foreign policy speech, energized President Bush into finally announcing an aid program of \$24 billion for Russia. The Administration's record until that time had been perceived as following the events rather than shaping them via decisive aid diplomacy and action. This was particularly so after the failed coup of August 1991, the disintegration of the Soviet Union, the formation of the Commonwealth in December and, finally, the vigorous start of economic reform under Yeltsin.<sup>1</sup>

As the International Monetary Fund (IMF), the World Bank and the G-7<sup>2</sup> vie with each other in

announcing sizable sums of aid to the former Soviet Union, blessed undoubtedly by President Bush's shift of policy in favor of substantial aid support, there are several questions to ponder:

- Why was the actual aid support for the Soviet Union under Mikhail Gorbachev so limited, despite public proclamations of goodwill?
- Could more aid support, and in what appropriate form, have been provided at the time to initiate and expand economic reforms?
- How will the proposed aid package under IMF stewardship now facilitate the implementation of the reform undertaken by Boris Yeltsin?

### TRADITIONAL CRITERIA OF AID

What answers does the experience with developmental aid, now three decades old, provide to these questions?

Commitment to democracy and markets is currently a necessary condition for aid. However, if the

1 The former Soviet Union is referred to in this essay as "The Soviet Union" when the events occur before its breakup. Markets refer to free markets.  
2 The G-7 are the leading industrial democracies of the United States, Japan, Germany, France, the United Kingdom, Italy and Canada.





history of past aid programs provides any lessons, such commitment does not suffice to qualify a country to receive aid. U.S. security interests must be safeguarded too.<sup>3</sup> For some time, for instance, nuclear nonproliferation has been an issue of utmost concern for global security. Even when a potential recipient meets all these criteria, there is the question of what economists call "absorptive capacity." Aid dollars should not be wasted. Indeed, they should be efficiently used so that the recipient benefits from the aid through growth instead of getting overloaded with a debt burden that cannot be serviced or repaid. Such a prospect is diminished when economic policies are faulty, the institutional infrastructure is missing, bureaucracy is rampant and corruption is widespread.

The donors may have problems even when the recipient is aidworthy. Aid appropriations are the result of endless lobbying, complex negotiations and legislative craftsmanship.<sup>4</sup> Available tax dollars have to be distributed among alternative uses, domestic and foreign, as the legislators see fit. Aid requests from the Administration are almost always whittled down by Congress, hardly ever raised. Currently, with the pressures to wind down the budget deficit, aid funding is particularly hard to justify and sell.

A vexing issue arises also from the difficulties of assessing the political direction of the aid-receiving regimes. Emerging democracies may be threatened with demise, whereas dictatorships may be under pressure to democratize. In such twilight instances, the criterion of giving aid to support democracies becomes blurred. Witness the historically-refuted distinction, introduced by Jeanne Kirkpatrick, between authoritarian and totalitarian (communist) regimes, implying that the former (but not the latter) are capable of democratic transition and hence

deserving of support. Note the continuing objective of the Bush Administration, not always backed by Congress, to support China with the Most Favored Nation (MFN) concession in the hope that such "coddling of China's aging rulers" (according to presidential candidate Bill Clinton) will nurture democratic elements among the leadership.

Thus, aid decisions are a notoriously unpredictable result of a host of economic and political considerations, often reflecting the security concerns of the time. Simple economic criteria such as need or potential productivity cannot explain the actual aid outcomes.

And, they do not, of course, in the case of the former Soviet Union (and, for that matter, Eastern Europe). By criteria such as per capita income, or the extent of malnourishment, relative to the countries of South Asia and Africa, the aid sums recently announced as totaling \$44 billion for the Commonwealth of Independent States (CIS) in 1992 alone are phenomenally large.<sup>5</sup> Nor are the returns from these flows guaranteed. They can largely be explained by strategic and political considerations, especially as motivating Europe and the United States (rather than Japan which is still a reluctant player).

## DIFFERENT TYPES OF AID

Aid comes in many forms. There are grants and there are loans: the latter must be repaid and are consequently worth less.<sup>6</sup>

Again, since loans may not be repaid—many countries in Latin America were in default in the 1980s—the high risk in areas such as the CIS requires that private loans be backed by government guarantees, so that if the borrower defaults, the

3 The list of potential aid beneficiaries changes with the policymakers' perception of who is for or against U.S. policy objectives. Thus, among the countries currently downgraded are Pakistan (for continuing with its nuclear weapons program), the Philippines (for having closed the U.S. naval base at Subic Bay), Yemen and Tunisia (for evidently having supported Iraq in the Persian Gulf war), and Somalia and Sudan (for the frequent anti-American positions of their regimes). See *Wall Street Journal*, 6 January 1992.

4 A case in point is the current footdragging in Congress to approve, without a strong appeal from the President, the Administration request for \$12 billion as the U.S. contribution to the additional \$60 billion in the IMF capital agreed upon, in principle, by the Fund members as early as June 1990. Rather than bell that cat, "Congress passed a six-month extension of U.S. foreign aid, including aid for the former Soviet Union—at an annual rate of \$14.2 billion through September 30" (*Wall Street Journal*, 2 April 1992). While thus creating an impression that only half the funding intended by the Administration was approved, the Democrats in the Congress also settled an old score with the following warning from Representative David R. Obey, the Chairman of the House Subcommittee on Foreign Operations: "The last time that foreign aid authorization was on the floor, the room was filled with Republican rhetoric attacking the Democratic foreign aid bill because it contained aid for the I.M.F.," he said. "If the Republican Party thinks the Democrats in the House are going to carry the Administration's water on this issue while they are shooting at us, they must be smoking something that is illegal" (*New York Times*, 23 February 1992). It is likely that authorization for new money in the Bush aid package will be linked by the Democrats in Congress to a permanent extension of unemployment benefits.

5 As I argue below, these sums are hard to interpret unless they are broken down into different components such as grants and loans, tied credits, etc.

6 Economists will call loans "aid" only insofar as their terms are concessionary. The common practice now is to compute the "grant-equivalent" of loans, i.e., to get at the concessional give-away element in loans.



repayment is still assured. When private parties borrow, the guarantee of the recipient government should be adequate. But the Russian central bank, which took over the Soviet *vneshekonombank* (the traditional guarantor of incoming loans), has little credibility now. The guarantees must come now from *foreign* governments or their institutions, exposing their taxpayers to the risk of a S & L type default. Insofar as such guarantees induce the inflow of private funds into the CIS, the benefit is immediate: the CIS is able to borrow at significantly less interest cost than if it did not have the guarantee.<sup>7</sup>

In turn, we must take account of the fact that aid may be tied to donor-country exports, thus preventing the recipient from importing its needs from the cheapest sources. In the case of the CIS, this has been true of the credit-financed sales of food from the United States and the European Community, both having pledged credits of over \$5 billion for the purpose. If the money were foot-loose, it is arguable that the CIS would have saved a sizable fraction of the cost of any given volume of food imports and would thus have emerged as less indebted in the future. On the other hand, the aid flow would have certainly been less.

### The Question of Humanitarian Aid

Aid flows can be either for productive purposes, which includes the entire task of making the CIS transition to markets successful, or for immediate consumption. The former is the chief purpose of aid programs. The latter is really a question of "humanitarian" aid, addressed to natural disasters such as droughts and floods or manmade calamities such as civil wars and pogroms.

It must be acknowledged that appeals by the liberal intellectuals in the 1950s to redistribute income from rich to poor nations on a continuing basis simply with a view to equalizing consumption never got to play in Peoria or on Capitol Hill. The distinguishing mark of humanitarian aid to support consumption is the presence of extreme distress and a natural appeal, therefore, to altruism.

The CIS has been the recipient of humanitarian aid. In fact, Secretary Baker convened the celebrated

international conference in January 1992 in Washington, when the Bush Administration was still hedging, because of the grave fear of starvation in the cities of the CIS during the winter.

It is hard to imagine that the citizens of the CIS would face starvation when one thinks of per capita incomes and consumption. But starvation is a function of effective access to food. As food disappeared from the fixed-price state shops and prices rose substantially in the black or open markets, the food shortages in certain cities, chiefly Moscow and Leningrad, and for groups such as elderly pensioners on fixed incomes, could mean certain starvation if immediate relief was not provided. So it was.

But such humanitarian aid is naturally self-terminating. It is hard to imagine it continuing year after year.<sup>8</sup> However, credit-financed food imports will continue for two reasons: the Soviet Union was a net importer and, until agriculture performs better and food distribution improves, this situation should persist; again, the pressure of farm lobbies in both the U.S. and the EC to tie aid to their exports will continue unabated.

### Technical Assistance

The least developed countries usually lacked basic infrastructure at the beginning of the aid programs in the 1950s. The building of roads and harbors, education, civil service, agricultural extension, etc., were of the utmost importance. It was recognized then, and is still appreciated, that unless these deficiencies were fixed at the outset, aid funds would produce inadequate results. The "absorptive capacity" of the recipient country was of critical importance.

The CIS faces the same basic bottleneck, but the activities that need to be fixed are different. The strengths of the educational system are in the sciences and not in management, finance, marketing, accounting and the many professions that support a market economy. Commercial banks have to learn the ways of capitalist banking. The distribution system, a bottleneck that has contributed to the food shortages in the cities, has to be set up—even bread is not wrapped, compounding the shortages. Technical assistance, aimed at creating this infrastruc-

<sup>7</sup> The difference between the market rate of interest and this lower interest charge is the grant-equivalent of loans mentioned earlier.

<sup>8</sup> Vladimir N. Lukin, the Russian Ambassador to the United States, suggested in a recent interview (*New York Times*, 4 March 1992) that "the former Soviet republics would most likely get through this winter without any famine, but that disruptions in planting this spring could lead to serious shortages next year."



ture, is therefore of utmost urgency and must be accomplished, or programs to flood the CIS with huge sums of cash will not generate the anticipated productivity gains.

### Aid from the IMF and the World Bank<sup>9</sup>

The IMF is a "club" that countries join (upon Fund approval) by paying a subscription called a quota, which corresponds to the size of their economies, their participation in world trade and the amount of their foreign exchange reserves.<sup>10</sup> If the Fund agrees, a member can draw on the quota in specific installments to tide over a temporary balance of payments deficit. These standby credits have to be repaid within three to five years. The Fund sets its conditions when it allows members to borrow from the pool. Since the balance of payments deficit results from a country living beyond its means, it must tighten its belt by spending less. The overall spending in the economy should be cut by raising interest rates. The budget deficit of the government must be curtailed by removing subsidies to consumers and state-owned enterprises, and by raising taxes. In addition, these macroeconomic measures should be pursued in an environment of free markets and open trade. Administered prices, import quotas, and high tariffs are no-no's. The Fund is known to be an even-handed and a demanding taskmaster for rich and poor alike. Membership in the Fund is necessary for a country to become a member of the World Bank.

The World Bank functions no less strictly but slightly differently. It borrows from the capital markets by selling bonds, and lends to member countries with a per capita income of less than \$4,000 at market rates, typically for five to ten years. By contrast, the soft-loan window of the Bank, the International Development Agency (IDA) lends to poor countries with average annual incomes of less than

\$750; these loans, which carry an interest charge of less than 1 percent a year, have to be repaid over a period of 50 years.<sup>11</sup> Another agency of the Bank, the International Finance Corporation (IFC), promotes private business via unguaranteed loans and equity investments. Over the years, the Bank's loan activity has shifted from supporting projects, such as power plants in the 1950s, to farming and education in the 1960s, to the loans of the 1970s and thereafter, supporting policy measures such as trade liberalization accompanied by a devaluation of the currency. Whatever the purpose, the bank also insists on "strings" and continuing supervision of the progress of the project, the infrastructural program or the promised policy change.

Both institutions provide cash to needy countries which must be used under their supervision in a market environment. While their goal of promoting markets arouses resentment from socialist leaders in the Third World and communist followers in the Second World (of the former planned economies), the fact that critical policy decisions in the institutions are made by leaders of the First World raises eyebrows too. Since the voting power in the Fund is assigned in proportion to the size of the quota, the United States with the highest quota of 19 percent can veto a policy decision which requires 85 percent vote altogether.

In the absence of a one-man-one-vote world, the relative ranking and the voting power in the hierarchy is of critical importance to old-timers and newcomers. Since the admission of the Soviet Union under Gorbachev had this political dimension, the need to admit the Soviet Union to IMF and World Bank membership to jump-start the deteriorating economy was ignored: this is a thesis advanced later in this essay.<sup>12</sup>

9 For an excellent review of the activities and policies of the IMF and the World Bank, see Clive Crook, "A Survey of the IMF and the World Bank," *Economist*, 12 October 1991.

10 These quotas are already announced for members of the CIS. Russia's quota at 3 percent (\$3.9 billion) and Ukraine's at 0.69 percent (\$912 million) are the largest. The quotas allotted to the other members are as follows: Armenia, 0.05 percent (\$62 million); Belarus, 0.20 percent (\$256 million); Estonia, 0.03 percent (\$43 million); Georgia, 0.08 percent (\$102 million); Kazakhstan, 0.17 percent (\$226 million); Kyrgyzstan, 0.04 percent (\$59 million); Latvia, 0.06 percent (\$84 million); Lithuania, 0.07 percent (\$95 million); Moldova, 0.06 percent (\$82 million); Tajikistan, 0.04 percent (\$55 million); Turkmenistan, 0.03 percent (\$44 million); Uzbekistan, 0.14 percent (\$182 million). The quota allotted to the fourteen members as a share of the Fund's existing capital amounts to 4.66 percent. Details are in *Financial Times*, 16 April 1992. When the Fund capital is increased by \$60 billion, the expected decline in the Russian quota to 2.5 percent will place Russia "on a par with the Netherlands in joint ninth place in the IMF's pecking order after the US, Japan, Germany, France, the UK, Saudi Arabia, Italy and Canada" (*Financial Times*, Weekend, 22 February/23 February 1992). While the new members will be required to put up a quarter of their quota in hard currency (with the balance consisting of their own currency), the former will be made available to them in loans or grants from the richer countries. They will be able to borrow amounts from the Fund equal to three to four times their quota.

11 While all members of the CIS will qualify for World Bank loans, only Kyrgyzstan, Uzbekistan and Tajikistan in Central Asia are poor enough to qualify for IDA loans.

12 There were other contributing reasons as well.



### Conditionality

A common thread underlying IMF and World Bank lending therefore is conditionality: you may continue to borrow only if you perform. Admittedly, this is a tougher problem for the World Bank which, unlike the IMF, is also popularly judged by the volume of its lending.

These institutions are also market-oriented and have much experience with both stabilization (IMF) and price reform (World Bank), two of the major problems confronting the CIS, though in somewhat novel ways. They (especially the IMF) are therefore the natural allies in any aid program to implement the CIS transition to markets.

The CIS is unlikely to accept conditionality without internal objections any more willingly than earlier beneficiaries of IMF and World Bank programs. Faced with "aid with strings," those who object to the nature of the strings will ally themselves with those who object to strings per se. The latter groups have been vocal in the Russian Congress of People's Deputies and in other states. The leadership has had to navigate carefully in these troubled waters, denying conditionality, affirming sovereignty and contriving to obfuscate unpleasant facts.

Gorbachev faced this predicament repeatedly. On the eve of his departure for London to attend the G-7 meetings, he declared: "Some of you may think that Gorbachev is going to crawl on his knees and plead for assistance from leaders of the leading industrial countries... This is just not serious" (*New York Times*, 13 July 1991). Currently, the insistence that Russia is seeking mutually beneficial cooperation continues. Fighting similar xenophobic pressures, Nursultan Nazarbayev, the Kazakhstan President, told his parliament: "Today, all countries without exception are working to attract foreign capital, and it is not considered a sellout of the homeland" (*Wall Street Journal*, 9 July 1991). Yeltsin adviser Georgy Arbatov described the explicit linkage between Western economic assistance and the overhaul of the socialist planned system as a "deal by which we sell our socialist soul and our ideals. ...This is humiliating and it discredits, I think, the whole idea of Western participation and assistance to the effort we make" (*Washington Post*, National Weekly Edition, 24-30 June 1991). More recently, during the legislative debates in the Congress of People's Deputies, one member who insisted on a Russian solution to Russia's problems, reminded the legislators that Russia was "not Peru or Paraguay."

### AID POLICY: FROM 1985 UNTIL THE AUGUST 1991 COUP

The total combined aid flows from the United States to the Soviet Union (credit-financed grain shipments, technical assistance and humanitarian aid) fail to impress. The promised Bush package now makes a break. Why?

The answer lies in the pulls and pressures to which policy formulation in Washington was subjected from the start of Gorbachev's emergence as the Soviet leader. The certainties of the Cold War days were replaced by the presumed unpredictability of Gorbachev's true intentions and by continuing concern about how long he would last. The task was complicated at every stage by new decisions under his leadership in the Third World and by unexpected developments in Eastern Europe. The hallmark of the U.S. policy response was therefore caution in the exercise of initiatives on all fronts.

Caution, of course, did not imply the absence of priorities. The first items on the agenda, defined by President Reagan and pursued subsequently, in dealing with a communist adversary and a superpower, were arms control and foreign policy. Progress on resolving these issues began with the signing of the Reagan-Gorbachev 1987 Intermediate Nuclear Forces (INF) Treaty, eliminating a class of intermediate range nuclear weapons in Europe (followed by the signing of the Conventional Forces in Europe [CFE] treaty in December 1990). In the Third World, the withdrawal of Soviet forces from Afghanistan began the winding down of similar Soviet activities elsewhere. Cuba and Vietnam, two Soviet allies, were pressured to withdraw from Angola and Cambodia.

Significant though these developments were, they were not decisive enough in promising a sustained momentum of Soviet good behavior as the Bush presidency got under way. If Gorbachev were to be overthrown by hard-liners, would Soviet domination of Eastern Europe emerge once more? That question continued to bounce back. The "what-if" challenges, befitting a Metternich, evoked the following response from George Bush: "'Who's the enemy?' he asked. 'Instability and unpredictability. I would repeat that I don't want to have two ships pass in the night, the Soviet Union and the United States'" (*New York Times*, 27 May 1990).



Four years into Gorbachev's tenure, the cautionary view prevailed. It discounted the possibility of the emergence of a Soviet threat in Europe but suggested a guarded policy response, called "status-quo plus."<sup>13</sup> On the other hand, the "break-the-mold" view, largely outside the policymaking orbit, recommended more substantial policy initiatives on the assumption that the Soviet threat was decidedly over.

### **The Status-Quo Plus Response on Arms Reduction and Foreign Policy Issues**

The status-quo plus approach was evidently a compromise between two positions in the Administration, characterized by Representative Les Aspin as the "stand-pat school" and the "seize-the-opportunity school."<sup>14</sup> According to this compromise view, because of the deteriorating economy the changes initiated by the Soviet leader were likely to continue even if he were removed.<sup>15</sup> These changes, however, called for marginal policy initiatives, via a broader dialogue and joint efforts, for resolving issues such as the conflict between Ethiopia and Somalia in the Horn of Africa, combating terrorism, and the spread of chemical weapons and ballistic missiles. There were no proposals on economic issues simply because, in the view of policymakers, economic changes in the Soviet Union would take a long time to yield results. Besides, there was no consensus on economic matters. On the issue of MFN benefits, for example, while some in the Commerce Department were in favor of granting the concession to promote liberalization of trade, the Pentagon was opposed to the move.

On the other side of the debate, the liberal outsider George Kennan suggested breaking loose from the old policy mold:

...it appears to me that whatever reasons there may once have been for regarding the Soviet Union primarily as a possible, if not probable, military opponent, the time for that sort of thing has clearly passed. That country should now be regarded essentially as another great power—one, that is whose aspirations and policies are conditioned outstandingly by its own geographic situation, history and tradition, and are therefore not identical with our

own but are also not so seriously in conflict with ours as to justify any assumption that the outstanding differences could not be adjusted by the normal means of compromise and accommodation. (*New York Times*, 9 April 1989)

In suggesting that Russia was no longer a threat, the "father of 'containment'" was arguing for "compromise and accommodation" rather than unilateral concessions from the Soviet side.

But the breathtaking turn of events in Eastern Europe forced the resolution of a series of issues into the fast lane. Successive communist governments fell, signaling the end of Soviet domination and resulting in demands for the withdrawal of Soviet troops. The Berlin Wall collapsed in November 1989, bringing the issue of German reunification into the open. Neither superpower could sit still.

Germany was reunited as a member of NATO, Gorbachev having surrendered his initial insistence on a "neutral" Germany. At the same time, a slow, scheduled departure of Soviet troops from Eastern Europe—380,000 in East Germany alone—was worked out. The process could have been speeded up but for the lack of jobs and housing for the returning soldiers.

Finally, nine years of negotiations in resolving the strategic arms issue culminated in the signing of the Bush-Gorbachev Strategic Arms Reduction Treaty (START) in July 1991, giving both superpowers the capability to deploy warheads at lower levels (approximately 10,000 warheads for the U.S. and 8,000 for the Soviet Union). The process, designed to take seven years from the approval of the treaty, stretched beyond the sudden breakup of the Soviet Union, creating new nuclear headaches for the policymakers.

In the end, despite a guarded approach of status-quo plus, arms control and foreign policy issues were addressed and resolved frontally. The process was pushed in part by unexpected events in Eastern Europe, in part by Gorbachev's concessions, in part by the Bush Administration's decisions.

By contrast, response to economic issues materialized at a snail's pace. At Malta in December 1989, almost five years after Gorbachev's emergence as Soviet leader, President Bush formally declared his

13 This approach was outlined in a classified report (*New York Times*, 9 April 1989), prepared at President Bush's request, by analysts in the Central Intelligence Agency, the State Department, the Pentagon and the National Security Council.

14 Cf. *New York Times*, *ibid.*

15 Such was the position of William Webster, the Director of Central Intelligence Agency, who, testifying before Congress, said (*New York Times*, 13 March 1990): "The economic pressures on Moscow are so severe that even a hard-line regime would be unlikely to begin a major military buildup or to try to revive the Warsaw Pact."



support for *perestroika*. The issue of economic aid was addressed much later, when Gorbachev brought it up at the G-7 London meeting in July 1991. He went home empty-handed.

### **The Status-Quo Zilch Approach on Economic Issues**

The reason for the "status-quo zilch" attitude toward economic support was simple. Such help was not to be given unless there were firm beginnings of democracy and markets on the Soviet scene.

#### *How Much Democracy?*

Take democracy first. *Glasnost* expanded horizons on many fronts. Elections were instituted for legislative bodies at the center and in the republics (although it was not until early 1990 that the monopoly of the Communist Party was formally ended). There was increasing freedom of the press and of the right to protest, which the reforming democrats exercised often and with vigor.

What was still in the making, however, was a constitution setting forth the powers of the center and the republics, and of the legislative and executive branches at each level with an independent judiciary. There could not be rule of law (*pravovoye gosudarstvo*) without its being defined in such a document. More to the point, the emergence of democratic institutions faced an uphill struggle in the absence of a civil society with pluralistic groups and a political culture. Nevertheless, political groups sprouted, some along ethnic lines, and the republics, led by the Baltic states, at first demanded autonomy and eventually fought for sovereignty.

The tragic death of protesters in Vilnius as Soviet tanks moved to crush a demonstration in January 1991 nailed the coffin on recognition, especially in the West, of the advances made in democratic rights. Then there was the appearance of armed troops in Moscow's Mayakovsky Square in March 1991, as protesters demonstrated against communist members in the Russian parliament plotting to oust Yeltsin—a clumsy attempt to restrain Russia's demands for self-assertion. Many asked whether *glasnost* had really managed to remove the show of military force from civilian and political life. In the

West, and the U.S. Congress in particular, independence for the Baltic states, forcibly integrated into the Soviet Union, served as the litmus test of democratic progress.<sup>16</sup>

The tense winter of 1991 eventually yielded to conciliatory initiatives from Gorbachev, motivated both by the realization that force was counterproductive and by his desire to resolve the issue of union-republic relationship in a union treaty. The 76 percent affirmative vote in the referendum on March 17, 1991, for preserving the union as "a renewed federation of equal, sovereign republics" provided the signal he needed. Soon after, his readiness to sign a union treaty with nine republics (including Russia) marked a tactical shift on Gorbachev's part and hope all around for political reconciliation. The content of that treaty, still taking shape, was fundamentally redefined by Yeltsin's election in June as President of the Russian Federation with a 57 percent popular vote. As the enormously popular leader of Russia and a crusader of sovereignty for all the republics, Yeltsin could no longer be ignored. The union treaty finally conceded the republics' sovereignty.

#### *Where are the Markets?*

As for markets, they were hardly visible. Administered prices were the rule. Policymakers from Aganbegyan to Abalkin, and politicians from Ryzhkov to Pavlov, all prisoners of the socialist mindset, thought in terms of raising prices via *diktat* rather than freeing them altogether.

But by 1988, new economic dangers were beginning to arise from excessive cash, the result of the public's past savings, and escalating budget deficits. With so many rubles, how high would prices go if they were to be freed? The fiscal problem was exacerbated in 1990 by the republics, especially Russia, demanding to withhold taxes, and in fact, retaining part of them in 1991 for their own use. The missing price reform and a growing fiscal deficit feeding inflation were now visible signs of an escalating economic crisis.

In the autumn of 1990, in this climate of an impending logjam, the Shatalin plan was presented for Gorbachev's approval. The plan called for price

16 During the Senate debate on a Soviet request of food credits worth \$1.5 billion on May 15, 1991, Republican and Democratic Senators with a wide spectrum of views from extremely conservative (such as Jesse Helms from North Carolina) to liberal (for example, Paul Sarbanes from Maryland) insisted on freedom for the Baltics before voting on the request. Senator Bill Bradley was consistently opposed to any such aid without the start of markets and freedom for the Baltic states. Senator Bob Dole, generally in favor of pushing farm exports, would not move forward in this instance without similar preconditions.



liberalization in two stages after the economy was first stabilized by a rapid trimming of the budget deficit and firm application of monetary brakes. In the meantime, privatization was to begin with a sale of small units in trade and services and to culminate with large factories in the final phase.

The plan gave the republics exclusive powers to tax and to retain a fraction of foreign exchange earnings for their own use. The center, a residual recipient of tax revenues and foreign exchange, was given the task of maintaining the internal and external value of the ruble. It was like asking the Federal government to control inflation in the American economy without granting it the authority to tax. That was its basic flaw. No central authority could have created and sustained macroeconomic stability and managed the external value of the ruble without the powers to tax. The plan's glaring inconsistency lay in its delegating macroeconomic functions to the center without corresponding macroeconomic powers to tax or to manage foreign exchange reserves during the transition.<sup>17</sup>

This was hardly the reason why Gorbachev turned it down. He understood these complexities less than his advisers. In view of the escalating centrifugal forces, his strategy was to have the republics first agree to a union treaty that defined the division of political and economic powers. Economic reform, in his view, could not begin without a proper demarcation, for example, of taxation powers at each level. In the meantime, an alternative framework had to be devised to supplant, if not bury, the Shatalin plan.

The Gorbachev plan resurrected taxation and foreign exchange functions for the center with an active role for the republics, but insisted on a unitary polity with hierarchical authority at each level—executive and legislative—flowing from the union to the republics to the lower levels. That was a mistake. A feasible compromise would have been to insist on a coordinating macroeconomic role for the center with republic participation, but to accept the loose political arrangements of the Shatalin plan that recognized the republics' sovereignty. These features had to be sorted out for incorporation in

the union treaty which the nine republic leaders had agreed to sign with Gorbachev before the coup took place.

In fact, two contending plans, the "anti-crisis" program of Prime Minister Valentin Pavlov (with input from the republics) and the transition package of Grigory Yavlinsky (with input from economists in Cambridge, Massachusetts) appeared in May, vying for Gorbachev's consideration as the draft of the union treaty began taking shape and the economy deteriorated.

The Pavlov package promised lower taxes for enterprises to boost production, speedy privatization and incentives for foreign investors (*Izvestiya*, 23 April 1991). Price liberalization and ruble convertibility were to proceed according to a phased timetable. The center and the republics were to coordinate their budgets. The plan, while eschewing commands from the center, emphasized the need for coordinated policies and "efficient organization on a countrywide scale." This prescription, coming from a diehard bureaucrat, did not provide assurance of liberal reform.

By contrast, the Yavlinsky plan presented a coherent framework for transition to markets (*New York Times*, 30 May 1991). It promised economic powersharing between the republics and the center, price liberalization, and effective monetary and fiscal policies for macroeconomic stabilization; it visualized demonopolization and privatization of industries and formulation of legal guidelines for encouraging foreign investment; it pledged support for protecting the living standards of vulnerable groups. In return, the plan called on the G-7 to give financial help to the Soviet Union, to work out ways to restructure its debt, to facilitate its entry in the international economic organizations and to set up joint institutions for monitoring Soviet use of outside resources. The signal was: we pledge to undertake the right measures but first promise us financial help on a large scale.<sup>18</sup>

This pie-in-the-sky scheme met with a cool response from Washington: economic reforms must be undertaken first and aid will follow in small doses.<sup>19</sup> The unanimous opinion, held by the G-7

17 For further analysis of the Shatalin Plan, and its contrast with the Gorbachev Plan that succeeded it, see Padma Desai, "Soviet Economic Reform: A Tale of Two Plans," *The Harriman Institute Forum* (December 1990).

18 The "Grand Bargains" of Jeffrey Sachs (*Washington Post*, 12 May 1991), and Graham Allison and Robert Blackwill (*Foreign Affairs*, Summer 1991) had a similar *quid pro quo*. The former argued for loans and loan guarantees of \$30 billion a year (with an annual U.S. contribution of \$3 billion) for four years in return for a radical economic program combined with freedom for the Baltic states and sharp cuts in Soviet military spending. The latter proposed grants of \$15 to \$20 billion a year for three years, "conditional upon continuing political pluralization and a coherent economic program for moving rapidly to a market economy."

19 According to Secretary of State James A. Baker 3rd (*New York Times*, 30 May 1991): "The first step, of course, is for the Soviet Union to undertake



and congressional leaders, was that large amounts were neither necessary nor available and would, in fact, be wasted.

Perhaps reacting to the negative sentiment toward massive assistance and watchful of the hardliners at home, Gorbachev took with him a less radical proposal to the July 1991 G-7 summit. Gone was the free market framework of the Yavlinsky plan with its implicit assumption of massive aid to support swift implementation. Instead Gorbachev sought help, presumably private investment, for transport, energy and environment, and for conversion of defense industry plants. The G-7 leadership reacted with promises of special association in the IMF and the World Bank, and offered technical assistance to help the Soviets convert their military sector to civilian industry, promote their energy, transport and food distribution systems, and improve nuclear safety. The cautious response was the result of the G-7's persistent doubts regarding Gorbachev's determination to introduce private property and liberalize prices. The letter of intention addressed to the G-7, a vintage Gorbachev document, dealt with these issues on the basis of pedagogic distinctions between the command and the laissez faire approaches to the market.

### "Still the Superpower" Syndrome?

The political developments, chiefly in regard to the Baltic states, represented regress on *glasnost* and dampened the enthusiasm for Gorbachev. The economic developments reflected a stalled *perestroika* and a deteriorating economy. Both factors killed any support for a large-scale aid program.

But did the continuing worry about the Soviet Union's superpower status contribute to this outcome? After all, the idea of providing aid to a super-

power could sound like an oxymoron; it could also raise the fear of shooting oneself in the foot.

These worries must account partly for the fact that a linkage between G-7 aid and reduction of Soviet armaments surfaced on many occasions, even while diplomatic niceties generally prevailed. The G-7 summit communiqué stated: "We are sensitive to the overall political context in which reforms are being conducted, including the 'new thinking' in Soviet foreign policy around the world. We are sensitive also to the importance of shifting resources from military to civilian use" (*New York Times*, 18 July 1991). While the G-7 appreciated the progress on this score, they wanted more. Brent Scowcroft, the President's national security adviser, reacted with skepticism to Gorbachev's claim in his letter to the G-7 that arms procurement had fallen 28 percent between 1988 and 1991 (*Financial Times* Weekend 13 July/14 July, 1991). Brian Mulroney, the Canadian Prime Minister, reflected on the situation in a down-to-earth fashion: "If your economy is in such difficulty, as it is, why do you spend such vast amounts of money in refurbishing the military?" (*The Independent*, 15 July 1991).

The continuing Soviet assistance to Cuba figured in the deliberations too. According to a Japanese spokesman (*ibid.*), the U.S. was as keen on taking an issue with Soviet aid to Cuba as Japan was in resolving the continuing Soviet occupation of the Kurile islands.<sup>20</sup> Closer to home, Senator Bill Bradley voiced the concern of many leaders regarding Soviet aid to Cuba and Soviet missiles aimed at the United States (*Wall Street Journal*, 17 June 1991).

All in all, while these issues were not directly linked to the denial of economic assistance, they figured in the deliberations and indirectly influenced the decisions on aid support.

[emphasis added] real market-based reforms, to use incentives to tap the very great potential that exists in the Soviet Union and the considerable resources and skilled people that exist in the Soviet Union. A week later, James Baker elaborated his position (*New York Times*, 7 June, 1992):

"The Soviets must start with self-help. If they do, we will support them. Indeed, we are developing a package of supportive measures, which we hope we can coordinate with you [NATO allies] and others. But I don't honestly think we can catalyze Soviet reform through a big bang approach. Our effort is more likely to be a step by step process—certainly one with a grand goal—but ever a realistic and workable approach. Chancellor Helmut Kohl of Germany echoed a similar view: "We are not in a position to finance a bottomless barrel... Moscow needs help to help itself" (*ibid.*). The Japanese view was forthright: "Japan wants to see reform implemented, not a promise of reform" (*ibid.*). At the Congressional end, the reaction of Representative Lee H. Hamilton, Chairman of the House Foreign Affairs subcommittee on Europe was typical: "I don't think that is politically feasible.... my reaction was that they are going to have to proceed on this not with the idea of some grand design, mega-treaty and massive infusion of aid but rather on some kind of step-by-step basis, in which we are prepared to extend some assistance after we see specific implementation of reforms. You are not going to see large-scale economic assistance at this time because of concern about pouring money down a bottomless drain" (*ibid.*).

20 Japan claims the four "small, windswept" islands of Etorofu, Kunashiri, Shikotan and Habomais, which are inhabited by 15,000 Russians serving the military garrison. The islands, while endowing Russia with wider fishing rights, are strategically important. The first step in the process of resolving the dispute is to recognize Japanese sovereignty over the islands. In addition to the unresolved territorial dispute, Japan's hesitation in agreeing to massive economic assistance arises from the chaotic economic situation devoid of a firm financial and legal infrastructure and secure markets.



### U.S. Economic Aid Before the August Coup

For these reasons, U.S. economic support turned out to be limited—symbolic promises rather than concrete material benefits. The President's predicament was by no means easy. While he evidently continued to be bothered by the possibility of the hard-liners taking over from Gorbachev, he was increasingly concerned also about the republic leaders exacerbating nationalist, ethnic demands and disrupting interrepublic links. During his visit to Kiev in late July of 1991, he talked to the Ukrainian parliamentarians about "suicidal nationalism." Gorbachev's middle-of-the-road policies, by contrast, seemed to provide stability. But the Soviet leader could not be rewarded with concrete economic aid when all that he did was stand between a hard-line takeover and chaotic disintegration. Symbolic support, as a vote of confidence, was all that President Bush could muster in this difficult situation.

Thus, the Soviet Union was admitted as an observer in GATT in late 1989. The entry brought it on a par with China which had been given that privilege earlier. But learning about the rules and obligations of trading in a multilateral environment was a bit like learning to drive an automobile without owning one. At the Malta summit in December 1989, President Bush had pledged his support for *perestroika* and promised to work vigorously on granting the MFN status to the Soviet Union.<sup>21</sup> The trade agreement signed by the two Presidents in early June 1990 promised the Soviets MFN benefits and full-fledged commercial relations. But Congress was unlikely to ratify the agreement unless the Supreme Soviet passed a law guaranteeing liberal emigration of Soviet Jews.

In sum, the criteria of economic aid to the Soviet Union on the eve of the coup were airtight. Despite decisive progress on arms control treaties and foreign policy issues, policymakers still viewed the Soviet Union as another superpower of concern to U.S. security interests. As for Gorbachev's contributions in liberating Eastern Europe, unifying Germany and bringing peace to Europe and the world,

he got financial credits from Europe, a pat at the GATT, further promises from Washington, and the Noble Peace Prize. The massive advances in democratic freedoms too were crowded out by unfulfilled demands, most importantly, sovereignty to the republics and independence for the Baltic states. Gorbachev's concern for the welfare of minorities in the republics and his desire for a systematic devolution of power to the republics was irrelevant to aid diplomacy, since it lacked credibility, coming from someone who ruled from Moscow. As for markets, he presented a bundle of contradictions, insisting that communism could be reformed into a market system. The policy consensus was that aid could not be absorbed effectively without functioning markets.

As a result, the aid decision was not really difficult for Washington policymakers. On the criteria of the existence of markets and absorptive capacity, Gorbachev's score was zero. His grade on introducing democracy depended on the grader but Congress would continue to give him failing marks until the Baltic states were freed. As for the criterion of safeguarding U.S. security interests, a superpower had to be judged severely rather than liberally, contrary to George Kennan's view that the Soviet Union was just another power. In the end, Gorbachev received food credits worth \$2.5 billion (which promoted sales of U.S. grain)<sup>22</sup> and \$740 million in technical assistance for use in 1991 and 1992.

## AID POLICY AND RESPONSE AFTER THE AUGUST 1991 COUP

The failed coup created fresh problems for the official aid community everywhere. Events took place at a breathtaking pace: several republics declared independence, electing ex-communists—some of them coup supporters—as Presidents. The popular vote in Ukraine for independence at 90 percent was stunning; Leonid Kravchuk, an ardent nationalist and former communist, a tactician so

21 With MFN benefits, the high tariffs on Soviet items fixed by the Smoot-Hawley Tariff Act of 1929 would be reduced to the same levels as those levied on similar items from other sources. According to Leonard Silk (*New York Times*, 8 June 1990), "tariffs on various Soviet textile fabrics now range from 40 percent to 83.5 percent; these would fall to a range of 3.4 percent to 16 percent. Duties on chess sets, now 35 percent, would drop to 3.5 percent. On average, duties on Soviet goods would fall to 5 percent from 40 percent."

22 The first \$1 billion credit, pledged in December 1990 and fully guaranteed without difficulty was extended by American banks; the second loan of \$1.5 billion, to be made available in three installments (of \$600 million in June, \$500 million in October, and \$400 million more in February 1992), was backed by federal guarantees after the President had certified (as required by law) that the Soviet Union was capable of repaying the loans. But with increasing concern about Soviet ability to pay, the first installment itself was delayed, American banks having refused to provide the financing. It was picked up by European banks under pressure from their governments. Details are in *New York Times*, 15 August 1991.



nimble he could “walk between two raindrops,” was elected President of Ukraine by a 60 percent vote.

With every republic having declared independence by popular vote, where was the need for a center, a union president, indeed for the Soviet Union itself? The denouement was accomplished at Minsk in “a coup by the good guys”: Yeltsin, Kravchuk and President Stanislav Shushkevich of Belarus buried the Soviet Union and formed the Commonwealth of Independent States. Gorbachev resigned as President on December 25, 1991.

### The New Issues

The new developments raised unexpected issues for Washington policymakers. When should the new states be given diplomatic recognition, qualifying them for entry in the various international organizations such as the United Nations? In what way should the INF, the CFE and the START treaties be enforced? What measures should be taken to prevent the sale of nuclear weapons and technology and the hiring of Soviet nuclear scientists by countries aspiring to become nuclear powers? What kind of institutional arrangements, promoting the cooperation of the Commonwealth on regional security issues, should be devised?

On economic matters too, the problems were complex. What arrangements were needed to guarantee the debt repayments by members of the Commonwealth? How should their desire to become full members of the international institutions, the IMF and the World Bank in particular, be handled? Finally, how should the West help them introduce markets and other reforms?

### The Response

By the end of February 1992, all former republics of the Soviet Union except Georgia had become members of the United Nations. As for guaranteeing the fulfillment of the arms control treaties, the task would prove complex to the point of eluding a satisfactory resolution. The U.S. supported the po-

sition that the weapons covered by the INF and START treaties be transferred to Russia and then gradually eliminated—at a cost of \$375 million approved by Congress.<sup>23</sup> After initial agreement and subsequent refusal, President Kravchuk has now agreed to the arrangement of having the weapons dismantled under international supervision. A \$25 million science and technology center is planned for Russia to divert the expertise of the top Soviet nuclear scientists for the development of civilian technologies. The Commonwealth members were admitted to the Conference on Security and Cooperation in Europe (CSCE) with a view to their future participation in preventing and containing ethnic conflicts such as between Armenia and Azerbaijan in Nagorno-Karabakh.

On economic matters, the Commonwealth's repayment obligations to the tune of \$3.2 billion on the G-7 official debt were rolled over till March 31. That arrangement, too, was later complicated by Ukraine's insistence on paying its obligations separately on a debt burden of 16.43 percent of the total. Increasingly, whether the members agreed to repay their obligations singly or jointly, the situation called for subsequent rescheduling: the Commonwealth, Russia in particular, failed to acquire enough hard currency.<sup>24</sup> Finally, the issue of the admission of Commonwealth members to the IMF revolved around the nettlesome problem of where to rank them—Russia in particular—in the membership pecking order in terms of their subscription to the Fund's capital. The decisions on the size of members' quotas had to be resolved expeditiously.

The immediate problem was to devise ways of assisting Russia and the rest of the Commonwealth with food aid through the coming winter months. The Administration had to surmount two fresh hurdles in putting together a substantial package. These were the increasing reluctance on the part of private banks to lend money to Commonwealth importers for purchasing American grain for shipment to Russia and elsewhere, and the rapidly declining Congressional inclination to approve

23 Currently, there are 12,000 tactical weapons in Russia and 3,000 in Ukraine and Belarus. The strategic nuclear weapons, 12,000 in all, are dispersed in Russia, Ukraine, Belarus and Kazakhstan. By April 1, Ukraine and Belarus were reported (*New York Times*, 1 April 1992) to have transferred 57 and 70 percent of their tactical nuclear weapons to Russia.

24 According to the estimates of Salomon Brothers (*Financial Times*, 26 February, 1992), households within Russia have stashed away hard currency to the tune of \$5 billion to \$10 billion instead of surrendering it, as required, to the monetary authorities; an additional \$15 billion to \$40 billion has disappeared in the form of illegal conversion of rubles into dollars presumably by the previous authorities to oblige former communist bosses. Yet additional amounts have leaked abroad through the classic techniques of overinvoicing imports and underinvoicing exports. In the latter practice, the exporter, by declaring less export earnings than actually obtained, keeps the difference abroad in Western banks. The importer, by contrast, demands more foreign exchange from the central bank than he actually requires and keeps the difference.



foreign aid as the election primaries turned national attention to domestic needs.

On the eve of the Bush aid package, U.S. aid (a little over \$5 billion) consisted of food, humanitarian and technical assistance, and outlays for containing nuclear proliferation.<sup>25</sup> Of the \$3.75 billion Commodity Credit Corporation credit guarantees beginning January 1991, \$3 billion was used to ship 19.5 million tons of grain. Humanitarian aid to finance and transport medical supplies amounted to \$130 million. Technical assistance, \$740 million for 1991 and 1992, was aimed at promoting the infrastructure for food distribution and processing, energy, transportation, housing and financial services. Finally, \$400 million were allocated for help with destroying nuclear and chemical weapons and preventing their proliferation. It was a lean program, with the bulk aimed at helping U.S. farmers. The Administration, it seemed, was still battling the demons. How secure was Yeltsin politically? Was a military coup still possible? Would the issues of the destruction of missiles and of the dangers of nuclear proliferation, if technology and scientists were to disappear abroad, be handled satisfactorily?<sup>26</sup> Even Nixon's warning of "losing Russia" was couched in terms of the Cold War fears of communism winning *de novo*.

As prices were set free in Russia on January 2, 1992, and chaotic transformation got under way, the question whether aid could be absorbed effectively came up too. And finally, the forthcoming presidential election placed the issue of domestic priorities versus foreign aid at the top of the list. The President was reluctant even to chaperon through Congress a request for \$12 billion to finance U.S. contribution to increase the IMF quota overall by \$60 billion. The United States was locked into a low-key response, despite Yeltsin's promise and the new challenges.

## Yeltsin's January 2, 1992 Reforms

Yeltsin essentially forced the pace when he announced on January 2, 1992, a far-reaching set of price reforms.<sup>27</sup> By freeing most prices, he literally plunged into a course of action that made the Russian situation one of "make or break."

It was a dramatic demonstration to the outside world that he meant business when it came to price reform. By contrast, Gorbachev's credibility had suffered on that issue; as I have noted, aid to him had been inhibited by the fact that the G-7 wanted market reforms before aid. Yeltsin's decisiveness had cut through that fog of doubt. It was hard not to reward him.

At the same time, Yeltsin's advisers had cast aside all prudence and earlier reasoning about the necessity of macroeconomic stabilization *before* the start of price reform. Without fiscal and monetary levers well under control, it was dangerous to let prices go. The increased prices could well start a wage-price spiral that, without fiscal and monetary discipline, would be impossible to restrain. At the same time, if the brakes were applied successfully, bringing the large fiscal deficit under control, the result would be severe unemployment. That possibility implied that large sums of money from donors would become necessary. It was a tactic several countries had used earlier to get aid: start a crisis, leaving interested donors with no option except to pay up.

While there was political astuteness to the reforms, geared at gaining large cash inflows, their economic aspects were chaotic. Privatization plans were vague, and budget deficits were slated to be cut by impossible amounts: the first quarter of 1992 was to have a planned deficit of 1 percent of Russian domestic product (11.5 billion rubles) compared

- 25 The U.S. contribution was 6.5 percent of the total amount of \$80 billion in assistance pledged since September 1990. Germany led with 57.1 percent of the total, followed by 18.5 percent by the European Community (including 7.4 percent by Italy), 3.6 percent by South Korea and 3.1 percent by Japan. About half, 48.1 percent was in the form of export credits and guarantees and 10.6 percent for balance of payments support. Complete details are in *New York Times*, 23 January, 1992. Just as U.S. aid was largely aimed at promoting grain sales, German assistance was tied with unification (in the amount of \$8.4 billion to build housing for returning Soviet soldiers) and exports from former East Germany (to the tune of \$22.9 billion supporting 450,000 workers who would otherwise have to be given unemployment compensation at steep German rates). Details are in *Wall Street Journal*, 7 February 1992. Part of the Bush aid program will include some of these funds already pledged but not used, thus making the largess smaller than it appears.
- 26 The linking of military and foreign policy issues with economic assistance persisted, perhaps with greater urgency, in view of the disarray on the issue of collecting and dismantling the nuclear weapons on CIS territory. From yet another perspective, the German Foreign Minister Hans-Dietrich Genscher emphasized the need for the rapid conversion of military factories to civilian production (*New York Times*, 24 January, 1992): "It is very hard to explain to our people that we are providing aid to countries manufacturing arms." The Japanese Foreign Minister, Michio Watanabe, affirmed that Japan sought the return of the Kurile islands before agreeing to a massive increase in aid to the Commonwealth (*New York Times*, 23 January 1992).
- 27 Prices of food, fuels, utilities and transport, which were raised three to five times, were regulated at those levels. Rents were left unchanged but wages were freed. Overall, prices had risen so much in relation to wages that one third of the Russian population earned incomes of less than 900 rubles per month—the new minimum wage to be introduced on May 1—in the first quarter of 1992.



with a deficit of over 20 percent in 1991.<sup>28</sup> If only one could wave a magic wand!

Inevitably, backtracking soon followed on this and other fronts, including a promise of \$200 billion credits to factories battling a severe credit crunch,<sup>29</sup> and postponement of the promised oil price hike. The April 1992 Congress of People's Deputies found the reformist government battling a coalition of liberal democrats (who complained of a severe decline in people's living standards), industry lobbyists (who complained of high taxes and severe cash-flow problems) and communists (who wanted the clock turned back). In the meantime, the G-7 had negotiated a debt rescheduling plan which, as noted already, had to be reworked on March 31, 1992. In short, no mechanism was in place to coordinate decisionmaking on issues such as separate currencies, monetary policies and debt rescheduling, or to launch the Russian reform on a steady, credible track.

But the strategy of triggering a substantial aid response did work. The flash of determination and the fear of chaos pushed the Bush Administration off the fence. The twin announcements of an aid package by the President, and the statement on the resource needs of the CIS by the IMF Managing Director, exhibited telltale marks of hasty improvisation that matched the ad hoc policies in Moscow.

## Head Start on Preparing for Full Admission to the IMF

As for the aid package, a careful accounting revealed uncertainties as to who was contributing how much and, in particular, the extent of the additional burden to the American taxpayer.<sup>30</sup> As for the IMF estimate of the hard currency balance of payments support to the CIS (*excluding Russia*) at \$20 billion, it is "subject to a 'large' margin of error" in the words of Michael Camdessus, the Fund's Managing Director.<sup>31</sup>

The total of \$38 billion (excluding the ruble stabilization fund of \$6 billion) for 1992 is probably the minimum amount required to finance the Commonwealth needs for food, raw material and spare parts imports, and debt roll-over. If interpublic trade falls further, more will be required from outside. If oil prices are raised, as they will be, the resulting dislocation in industrial activity in the Commonwealth will add to these imports. If reforms start everywhere, and if their pace quickens in Russia so that market discipline is enforced and farms and factories cease having recourse to soft credits and state subsidies, the shortages of materials will intensify even more because of closures. The estimate, preliminary as it is, will turn out to be off the mark, requiring provision for more in the future.

Both packages thus create impressions of political expediency. Interestingly, both the Bush Administration (leading the G-7) and the IMF

<sup>28</sup> Three new taxes, a value added tax (VAT) of 28 percent which replaced sales and turnover taxes, a profits tax of 32 percent and an enterprise social security tax of 37 percent, were the main features on the revenue side. On the expenditure side, military spending and investment were drastically reduced. At the same time, the increased prices paid by consumers were expected to curtail the massive subsidies paid out earlier through the state budget. The first quarter budget deficit turned out to be 84 billion rubles. On the revenue side, there was a shortfall of 230 billion rubles, accounted for by a shortfall of 86 billion rubles in VAT and massive tax evasion by enterprises in the autonomous regions and republics. Yegor Gaidar, in charge of the reform, presented a budget to the parliament with a budget deficit of 11 percent for the whole year which it refused to pass in March.

<sup>29</sup> Higher prices for the majority of enterprises have implied lower sales and cash receipts, unpaid bills and higher borrowing from banks and from each other to pay the workers. Unlike managers in a market economy, they have not lowered prices or laid off workers. (Unemployment has risen very little—from 70,000 at the start of the year to 118,000 by the end of March.) The main reason for their unwillingness to lower prices is the anticipated rise in the price of oil from the current 350 rubles per ton by a factor of eight to ten in June, which was earlier scheduled to take place in April.

<sup>30</sup> The aid package consists of a \$6 billion ruble stabilization fund, \$4.5 billion in loans from international financial institutions, \$2.5 billion in deferral of debt liability payments and \$11 billion in bilateral credits from the G-7 for financing exports including grain, materials and spare parts. The ruble stabilization fund will come from the IMF provision of General Arrangements to Borrow (GAB) under which the Fund can borrow from eleven rich countries to assist any member. The debt deferral will be provided by countries (excluding the United States) from which the Soviet Union had borrowed before January 1, 1991. Finally, the \$11 billion bilateral credits are a ragbag of current credits already promised by donors (including the G-7), and their potential pledges. Little is new or definite in this item. A significant portion of the U.S. contribution to the program is already appropriated by Congress (for example, \$565 million in humanitarian assistance), or would not require a Congressional vote (for example, the U.S. share of 1.6 billion in the ruble stabilization fund which will come from the GAB—a practice which was voted by the Congress a decade ago), or would not add to the federal budget deficit (for example, the U.S. contribution to the IMF which will need authorization from the Congress but will count as a positive entry in the U.S. account with the Fund). Details are in *Wall Street Journal*, 2 April 1992. The U.S. share of the total is estimated at \$4.35 billion (*New York Times*, 2 April 1992), consisting of \$2 billion in bilateral credits, \$0.85 billion as contribution to the IMF and World Bank loans, and \$1.5 billion as share of the ruble stabilization fund.

<sup>31</sup> Assuming that these states do not ask for ruble stabilization funds, the aid figure of \$20 billion is comparable to \$24 billion for Russia. If one were to project this amount (needed in 1992) into the future, they would all need "\$140 billion or more over the next four years or so." The IMF would invest \$25 billion to \$30 billion over the next four to five years (and the world Bank would contribute \$12 billion to \$15 billion over the same period) if the reforms meet Fund approval. Finally, private investment is expected to contribute to the resource flow. The figures are provisional estimates of aid requirements rather than definite pledges attributable to specific sources.



relinquished their earlier condition that market reforms be introduced before the Soviet Union would be eligible for full membership. At present, only Russia meets that criterion seriously, yet all the Commonwealth states are to be admitted and financed.

## IMF STEWARDSHIP

Clearly, the IMF will now be the international agency and the major instrument through which the G-7 will execute their aid objectives.

It is ironic that such a course of action which could have strengthened Gorbachev's hand against the hard-liners and provided him with the expertise necessary to guide and monitor the reform programs was not seriously considered.

Indeed, the issue of full Soviet membership to the Fund appears to have been raised by Chancellor Helmut Kohl, perhaps supported by France and Italy, at the 1991 G-7 meetings (*New York Times*, 19 July 1991).<sup>32</sup> The United States and Japan were not ready for such a step. The arguments advanced against the move were that the Soviet economy had not stepped into a market system; that a full membership could take up to two years whereas an associate status, qualifying the Soviet Union for badly needed technical assistance, could be given right away; that it would start receiving huge amounts of financial assistance—a highly undesirable outcome—on becoming a full member; that the prospects of such a drain would jeopardize the Administration's request before the Congress for \$12 billion as American contribution to the additional IMF capital of \$60 billion; finally, that Soviet admission might dislodge the U.S. veto in the seven-member policy-making board of the IMF. These arguments were flawed, and the fears groundless.

To start with, nonmarket economies such as Yugoslavia and Romania had become full IMF mem-

bers early on. The prolonged preparation involved in clearing full Soviet membership should have accelerated the process rather than postponed it. An early start would have provided enough time for the amount of the Soviet quota to be sorted out at an acceptable level. Finally, IMF members qualify for financial assistance only after they have agreed to an economic package approved by the Fund. Members of Congress needed to be reassured on this issue. A formal announcement of an eventual full membership would have given the IMF a proper mandate for preparing a reform package.<sup>33</sup>

Unfortunately, this opportunity, which could have lifted the aid decision out of a totally passive mold, was missed. The criteria of requiring democracy, markets and absorptive capacity, and safeguarding Western security interests and American foreign policy objectives were applied to the hilt until the August coup. Indeed, so relentless was their application that the concrete step of early preparation and timely admission of the Soviet Union into the IMF, which could have engaged the donor community systematically on the economic scene, was not implemented. As a result, the Bush aid package and the IMF announcement of the CIS financial needs have turned out to be hastily improvised and politically expedient.

It would be foolhardy to claim that if the opportunity had been seized, it would have altered the course of Soviet history: the Gorbachev course and destiny may have traversed the same path. But the rapid admission of the Soviet Union to the IMF would have contributed to the timely evolution of a coherent economic reform program backed by adequate resources from the G-7.

## WHAT NEXT?

Now that the die is cast, what future awaits the course of reform in the Commonwealth under IMF steering?

32 The request of Jacques Attali, the Director of the European Bank of Reconstruction and Development (EBRD), that the restriction, limiting EBRD loans to the Soviet Union at 6 percent (identical to Soviet share) of the bank's capital, be removed was also turned down, presumably at U.S. and German insistence, for fear that the removal of the ceiling might drain bank funds away from the smaller countries of East and Central Europe. On reaching Moscow, Gorbachev sent a letter to the Fund asking for full Soviet membership, a move which surprised and even annoyed some of the participants.

33 An appropriate time for such an announcement would have been in the spring of 1991 during Evgeny Primakov's visit to Washington when he presented the Yavlinsky plan. By that time Gorbachev, who had started moving in the pro reform direction with plans for a union treaty, needed a decisive gesture of support from the G-7 with a promise of full Fund membership conditioned on his accepting the approach of the Yavlinsky plan with suitable modifications worked out by the Fund about the pace of reform and the amount of foreign aid. The three-volume Study of the Soviet Economy, prepared by the IMF, the World Bank, the Organization for Economic Co-operation and Development (OECD) and the EBRD (commissioned by the July 1990 Houston summit), was already out in February 1991 facilitating a speedy Soviet entry in the Fund. Such a step would have moderated the chaotic ad hocism which characterized the G-7 economic response after the coup. In my "Aiding Moscow: The Quid Pro Quo Approach" (*New York Times*, Letters, 28 May 1991), I had suggested the need for Soviet entry in the IMF and the World Bank.



In general, the Fund will insist on stricter monetary controls, smaller budget deficits, quicker price liberalization and speedier privatization than the policymakers are willing to concede and able to deliver. The political drama in Moscow, during which the reformist government almost came crashing down in midflight graphically conveyed the width of the chasm that needed to be crossed in one leap. While the Fund correctly insists on the instruments of the marketplace, it is known to set manageable targets of budget deficits, monetary discipline, and foreign exchange management. But once the targets are agreed upon, they can be violated by the member country only at the risk of interrupting the financial support from the Fund.

The set of specific targets and necessary policies will in fact emerge from the broad approach the Fund adopts in managing the transition in Russia as the leading candidate. Paraphrasing the words of its Managing Director, the task is unprecedented, the problems are daunting, the process will have its ups and downs, and the results will be long in coming. This does not seem to be the message of a shock therapist. It is, therefore, possible that the price of oil will be freed in two steps rather than in one jump. It is likely that the ruble will be made convertible for foreign trading after the financial situation is somewhat stabilized, rather than right away when the stabilization fund is formally announced. While the Fund will insist on a strict

monetary policy, its implementation may well proceed in the context of a step-by-step reduction of the budget deficit.

As we follow the course of this drama, it is worth recalling the reaction of Lech Walesa, a combative leader prone to authoritarian tendencies, who continues battling the communists, dealing with the IMF (he knows he has no choice), and engaging Western donors and investors in a somewhat more manageable Poland:

The government he named after his election, like much of the world, "thought it was possible to change the economy rapidly," he says. Now, the experience of escalating unemployment and unremitting recession has shown him that "it is impossible to shed communism in a straightforward way. ...Our revolution isn't the result of wishful thinking. ...It results from the development of civilization. It's connected with satellites, international phone calls. Even if another Stalin arose, he wouldn't be able to do what the original did. The direction is firm. No one can turn it back. What we don't know is how much it will cost and how long it will take." (*Wall Street Journal*, 19 March 1992)

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